American Council of Life Insurers

David Leifer
Vice President & Associate General Counsel

Carolyn Cobb
Vice President & Chief Counsel, Reinsurance & International Policy

Mariana Gomez-Vock
Assistant General Counsel

August 30, 2018

Justin C. Schrader, CFE
Chief Financial Examiner, Nebraska Department of Insurance
Chair, Liquidity Assessment (EX) Subgroup
Justin.Schrader@nebraska.gov

Re: Comments Scope of Insurers Subject to Liquidity Stress Test

Dear Mr. Schrader:

The American Council of Life Insurers (ACLI) advocates on behalf of approximately 290 member companies dedicated to providing products and services that contribute to consumers' financial and retirement security. ACLI members represent 95 percent of industry assets, 93 percent of life insurance premiums, and 98 percent of annuity considerations in the United States. 75 million families depend on our members' life insurance, annuities, retirement plans, long-term care insurance, disability income insurance and reinsurance products. Taking into account additional products including dental, vision and other supplemental benefits, ACLI members provide financial protection to 90 million American families.

Thank you, as always, for the opportunity to comment on the important work of the NAIC Liquidity Assessment Subgroup. Our comment letter is divided into two parts. In the first section we highlight some process issues and questions. While many of these have been raised on prior occasions, we think it important to continue to focus on these issues and questions as their resolution will be integral to the overall success of any liquidity stress testing framework. And we reiterate that we believe the Subgroup should adhere to its previously announced intention to carefully weigh the burden of any liquidity stress testing requirements against the insights likely to be gained from such an effort. We understand the stated policy objectives of the Macro-Prudential Initiative but remain concerned that a hastily constructed liquidity stress testing framework will fail to advance regulatory objectives while imposing substantial burdens on the insurance groups subject to the framework. Field testing will be essential in developing thresholds for inclusion, and determining whether the selected criteria are effective.

The second part of our comment letter briefly addresses the Proposed Criteria for inclusion in the stress testing framework. We are not sure, based on what we know, whether the six (6) criteria identified are correct. Several criteria raise questions as to whether they are fit for the purpose as proposed to establish the scope of the liquidity test, and much more work needs to go into the specifics of these criteria.

ACLI also has a suggestion that we hope will be received in the constructive spirit in which it is offered. We think the creation of a regulator/industry workshop may provide a mechanism within which information and ideas can be exchanged and evaluated in thorough, interactive manner. Such a

American Council of Life Insurers
101 Constitution Avenue, NW, Washington, DC 20001-2133
(202) 624-2128 t (866) 953-4096 f davidleifer@acli.com
www.acli.com

workshop could begin its deliberations soon, and also convene after field testing has yielded results sufficient for analysis. The Academy of Actuaries may also be interested in participating, and their expertise and input would be most welcome.

Process Issues and Questions

Size and Activities of Scoped-in Groups:

The revised NAIC Scope memo emphasizes the outward looking, macroprudential objective of the liquidity stress testing framework, while also noting the potential value for legal entity and prudential group regulators. These different objectives/purposes may lead to somewhat different conclusions about fundamental elements of any stress testing framework. We continue to believe that a purpose based on an "outward" look to potential risks that could be transmitted by the life insurance industry to the broader financial services sector may be limited to very large life companies. We also continue to urge that scope/objectives of the stress testing framework be clearly determined as that will help drive decisions around process and criteria. For example, depending on the scope/objectives, it may be more appropriate to test individual legal entities, or the entire group, and this may also change the thinking on the thresholds by activities. If one or more activities are above the threshold for a particular company (legal entity or entire group), then it would be more appropriate (and less challenging from an implementation standpoint) to test the entire legal entity or group, distinguished from trying to isolate the particular activity and the assets backing that activity.

Twenty-one (21) groups strike ACLI as scoping in more than necessary. Our expectation based on informal conversations with regulators was that only roughly half that many groups would be appropriately scoped in for a macroprudential purpose. An inward-looking, prudential approach would necessarily be more technically rigorous, and we continue to question whether it is a worthwhile use of limited regulatory and industry resources to establish the additional capabilities that will be needed to analyze individual company models in such a way that accurate conclusions can be derived.

Apart from the number of groups scoped in to the framework, we would like to better understand how the monetary thresholds were determined, especially as they vary among the criteria. In addition, we understand that some of the decisions regarding thresholds were made in regulator-only sessions because specific company information was included in the discussions. While we strongly support the confidentiality of company data (see below), we hope that as much of the discussion and debate surrounding this and other aspects of the MPI Project are in the future conducted in open forums.

Regulator Identification and Authority:

It remains opaque to ACLI member companies which regulator(s) will request/compel liquidity stress testing and under what authority. As suggested in our previous response, the timeframe and commitment expected of both regulatory and industry resources for this project should be articulated early in the process. Is it anticipated the NAIC itself will collect the stress testing data and analyze potential risks to the broader economy? Under what authority would that activity be undertaken? Would any data and/or analysis be made public and, if so, what and how? Would other standing NAIC committees be involved? We presume that the lead state regulator would be key to this process, but that has not been discussed publicly to our knowledge. These are just a number of questions we urge the Subgroup to address as early as feasible.

Use of the Data and Confidentiality:

Our view is that any data published should not identify individual groups. Liquidity stress testing and the risk profile of any particular group will vary based on, among other factors, market conditions/fluctuations and the potential role of risk mitigation tools. Without a complete understanding of these myriad factors, dissemination of individualized data could lead to misunderstandings by analysts as well as public policy makers. As is the case with the NAIC Group Capital Calculation ("GCC"), we would hope that any liquidity stress testing framework would be utilized as a "tool" that may provide insights for regulators but does not contain any automatic or compulsory regulatory ramifications. We also would have serious concerns with any intention to use liquidity stress testing as a comparability tool among and between groups, or as a benchmarking exercise. Such efforts could easily have unforeseen consequences and may inspire business model changes (arbitrage), which would be to no one's benefit.

Timing and Revisions:

There has been no discussion to date regarding the timing and other mechanics of a liquidity testing framework. Is it foreseen that each scoped-in group will conduct this stress test annually? Will revisions to the criteria/thresholds be made based on results? Is the list of scoped-in groups intended to be static or will groups potentially rotate on and off the list based on the collected data? Who will notify the scoped-in groups of their inclusion? As a general proposition, the longer the horizon, the more focused on capital; the shorter, the more focused on liquidity. As an aside, it does not appear that all twenty-one (21) groups identified in the attachment to the exposed memorandum have been notified of their inclusion, or at least had not been done so prior to the exposure of the scope document. We hope greater communication will characterize future work on this project.

Complexities of Liquidity Stress Testing

ACLI understands that the NAIC anticipates using a cash flow basis for liquidity stress testing--believing it will provide better results than a balance sheet approach. However, it is not yet entirely clear what will be involved in a cash flow basis; further defining and clarification is needed. In addition, cash flow liquidity stress testing is inherently complex, and we would welcome a discussion around the additional resources that will be needed from individual state regulators, the NAIC, and industry to successfully develop and maintain this project. Will lead states be relying on the NAIC to conduct reviews of stress testing results? This is a major initiative that will require substantial technical resources, and we hope the Subgroup takes the time to carefully think through the many facets of this project. To that end, we suggest a revised timeline of the Subgroup's future activities be published for comment. The previous timeline (published by the Financial Stability Task Force) has understandably slipped, and a recalibration of expected deliverables would be useful.

Criteria Considerations for Liquidity Stress Test

Fixed and Indexed Annuities:

We preliminarily note that the Liquidity Assessment Subgroup recently made several significant changes to the Life Blank expected to provide relevant information pertaining to any potential macroprudential risks associated with these products. It may be preferable for this data to be collected and analyzed prior to imposing a substantially more complex regimen on life insurer groups. Not all of the reserve for fixed and indexed annuities is subject to discretionary withdrawal, and features including surrender charges vary greatly to reduce the amount available upon a discretionary withdrawal. Inclusion of these products will have to be carefully circumscribed if useful data is to be obtained. We note that individual fixed annuities includes

SPIAs, and the group fixed annuities includes pension risk transfer, neither of which typically presents liquidity risk as cash values cannot be withdrawn on a discretionary basis.

Derivatives:

The majority of life insurance derivative use is for hedging purposes only, with state regulations limiting the overall size of a life insurer's derivatives book relative to the amount of admitted assets a life insurer holds. This is a key mitigating factor to liquidity risk because these assets can be used to satisfy derivative collateral requirements. Typically, most life insurers require customized derivatives to hedge the market risks inherent in some products offered to clients and in the assets purchased for the general account. Customized derivatives trade in the bi-lateral over-the-counter market where the assets eligible for pledging to dealers in a collateral arrangement are broad and include most of the high-quality assets insurers own. Therefore, it is unlikely life insurers would need to liquidate a large block of assets to satisfy over-the-counter derivative margin calls. Instead, life insurers would typically pledge high-quality fixed income general account securities, mitigating liquidity risk arising from life insurer's hedging activities. Life Insurers retain legal ownership rights of assets pledged under these arrangements and these assets continue to be included in Life Insurers' Admitted Assets.

Funding Agreements and GICs:

The inclusion of all elements of these instruments appears overly broad based on what we know currently. Some examples for further consideration: Funding agreements and GICs only expose companies to material liquidity risk if the policyholder has the right to surrender the instrument. Typically, FHLB funding agreements cannot be surrendered by the FHLB. The GIC definition likely sweeps in both institutional and retail GICs (such as GICs within a 401K plan). The liquidity relevance would only extend to institutional GICs. There are many products within these broad categories, such as annuities certain and supplemental contracts that also do not in our view contain any liquidity risk. Synthetic GICs do not pose liquidity risk at the magnitude of the amount of business wrapped. As these examples illustrate, the appropriate products in this category should be carefully investigated prior to any decision of inclusion. In addition, the time horizons should be considered and limited in terms of how far in the future projections are extended. Lastly, we believe greater analysis should be applied to the thresholds, and the Funding Agreements and GICs category should be raised to $25 billion to be on par with Fixed and Indexed Annuities.

Securities Lending:

We believe, as a basic principle, that securities lending might be appropriate as a stress test criterion. As with all the proposed criteria, companies conduct business in particular ways which need to be considered with their lead state regulators if accurate outcomes are to be achieved. For example, the 2009 NAIC's Securities Lending Subgroup of the Statutory Accounting Principles Working Group was made of reduced capital charges contingent upon certain conforming program language and reporting. Additionally, other management actions, such as increasing secured borrowing in response to or in connection with market stresses associated with securities lending is highly relevant. For this reason, models that do not reflect management actions under a liquidity stress event, as contemplated in prior exposed material of the Subgroup, would miss critical information. If the NAIC adopts a cash flow approach, properly documented management actions to mitigate risks should be reflected.

Repurchase Agreements:

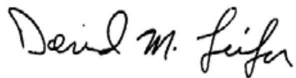
We do not have specific comments on this criterion at his time. After the scope on this project is ascertained, life insurers would like to preserve the opportunity to address repurchase agreements as the NAIC's project evolves further.

Borrowed Money (Includes Commercial Paper):

We believe this is an appropriate criterion where useful liquidity risk could be measured.

Thank you again for the opportunity to comment, and please let me know if we can provide additional information.

Sincerely,



David Leifer

CC: Elise Liebers, Senior Director, NAIC
Todd Sells, Director, Financial Regulatory Policy & Data, NAIC
Ani Verma, International Insurance Technical Policy Advisor, NAIC